

# Joint Ventures, Teaming Arrangements and Other Viable Tools to Grow Your Business

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- **IMPORTANT NOTE**

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## WHAT IS A JOINT VENTURE?

- An association of two or more persons to carry out a single business enterprise for profit for a limited purpose or time.
- Persons combine in the business enterprise for their mutual benefit with the understanding that they are to share in the profits and losses and each is to have a voice in its management.

## PURPOSE OF A JOINT VENTURE

- Allow companies to share strengths, minimize risks, and increase competitive advantages in the marketplace.

# HOW TO STRUCTURE THE JOINT VENTURE

- Properly define the scope of the joint venture
  - Identify form of the joint venture
- State what each person's/company's responsibilities are
  - Include capital contributions to the joint venture
- State how profits, losses and revenue will be allocated or distributed
  - Define the term of the joint venture
- Consider restrictive or non-compete covenants as well as potential conflicts
- Set up bank account where proceeds from joint venture can be deposited
  - Address resolution of any disputes that may arise
    - Tax implications

# POINTS FOR MBEs TO CONSIDER IN STRUCTURING THE JOINT VENTURE

- Demonstrate responsibility for a clearly defined portion of work to be performed with own forces
  - Demonstrate capacity to share in ownership, control, management responsibilities, risks and profits of the joint venture
- Amount of money invested reflects the percentage of participation by parties to joint venture for purposes of contract goals
- Interest in control, management, risks and operation of joint venture should be commensurate with members' percentage of ownership
  - Reveal managerial and financial responsibilities
  - Opportunity to exercise independent judgment
- For most part, the joint venture itself cannot be certified as an MBE

## WHAT IS A TEAMING ARRANGEMENT

- Involves two or more companies coming together and combining resources, generally to bid on a government contract
- Generally, a larger company serves as the prime contractor and smaller companies serve as subcontractors

## PURPOSE OF TEAMING ARRANGEMENT

- Compete for larger or more technically complex contracts by combining capabilities, assets and resources of team members
- Primary concern – smaller companies (subs) may not receive share of work expected if project bid on is awarded



- Government will recognize integrity and validity of team arrangements, provided that arrangements are identified and company relationships are fully disclosed in bid offer, or for arrangements entered into after submission of a bid offer, before the arrangement becomes effective

## AFFILIATION

- Businesses in teaming arrangement viewed as separate business entities
- Teaming arrangements are usually structured to avoid being construed as a joint venture
- Joint ventures are considered "**affiliated**" –considered a single entity for size determination purposes
- Affiliation generally arises where one concern is dependent on another for contracts and business to such a degree that its economic viability would be in jeopardy without such contracts and businesses

## HOW TO STRUCTURE TEAMING ARRANGEMENTS

- Properly define the scope of proposal or bid and what each person's role is in the proposal process
  - Divide up responsibilities and divide work between the parties regarding the proposal
  - State the relationship between the prime contractor and subcontractors (to demonstrate no affiliation)
- As contracts awarded are awarded to the prime contractor, state in arrangement what is to occur if the prime is awarded the contract
  - State how costs, expenses and risks will be dealt with
  - Consider and state how proprietary information is controlled and protected
    - State how arrangement will be terminated
      - Resolution of any disputes

## POINTS TO CONSIDER IN SELECTING JOINT VENTURE OR TEAMING PARTNER

- Do your homework – find out everything you can about potential partner
  - Talk with vendors, contractors, subcontractors that potential partner has worked with
- Request financial statements to ensure financial stability
- Take time to build rapport and relationship with potential partner

Contract Particulars  
(see handout)

## Contract Particulars

1. **Independent or Sub-Contractor Agreement** An Agreement between the Company and a third party non-employee for the performance of services related to a specific task or project for the benefit of the Company and/or Company's customer.

- (a) Project Particulars
  - (i) Description of Project with detail.
  - (ii) Clear description of change order procedures.
  - (iii) Term of Project or Agreement (can be "task order" based)
  - (iv) Fee – paid upon services rendered or paid as, if and when customer pays
- (b) Clear Statement of IC status
- (c) Confidentiality, Non-Disclosure and Intellectual Property
  - (i) Confidential Company information remains confidential and IC cannot use the information for its or anyone else's benefit unless it becomes non-confidential
  - (ii) Term of confidentiality obligation is negotiable (i.e., 2 years or "for so long as the owner of the confidential information treats such information as confidential").
  - (iii) How is intellectual property created during the Term of the Project handled? Is it work made for hire and assigned to Company or is it licensed to Company?
- (d) Non-solicitation of Company employees or Company clients – this is ok.
- (e) *Non-competes – are not appropriate*
- (f) Indemnification and limitations of liability
- (g) Dispute resolution
  - (i) Arbitration or legal remedies
  - (ii) Injunctive Relief – appropriate for violations of confidentiality, non-disclosure and non-solicitation clauses

2. **Teaming Agreements.** Agreement between two companies to pursue contract with a third party for a prime contract. Teaming partners will then enter into a JV agreement or sub-contract upon award of prime contract.

- (a) Description of Prime Contract being sought
- (b) Description of roles and responsibilities of each teaming partner.
- (c) Limitations on direct contacts by either party with customer.
- (d) Conflicts of interests – subcontractor may not team with other primes for same contract.
- (e) Confidential information and Invention rights
- (f) Termination of Agreement –
  - (i) Execution of subcontract or JV agreement
  - (ii) End of specific time period (12-24 months)
  - (iii) Customer awards contract to third party
  - (iv) Unable to enter into subcontract
  - (v) Cancellation of project by customer
  - (vi) Prime's decision not to pursue prime contract
  - (vii) Suspension / debarment, etc.

# Independent Contractors vs. Employees



- Bureau of Labor Statistics (February 2005):
  - more than 10.3 million workers in U.S. treated as Independent Contractors
  - roughly 7.4% of total employment
- DOL study (2000):
  - 10-30% of companies in nine states misclassified workers
- IRS (1984):
  - employers misclassified 3.4 million workers
  - \$1.6 billion in lost tax

## What is being done?

- IRS to audit 6,000 Companies
- Middle Class Task Force
- State and Federal Cooperative Agreements

## The Law

- Test varies depending upon the particular law
  - Common Law Agency Test (NLRA, ERISA)
  - “Economic Realities” Test (FLSA)
  - “ABC Test” (unemployment insurance)

### IRS “General Rule”

IC status if recipient of services has right to control or direct result of work and not means and methods of accomplishing result

# RISKS OF USING INDEPENDENT CONTRACTORS

1. Inadvertent Coverage of Independent Contractors Under Employee Benefit Plan
2. Tax Liability
3. Discrimination Liability
4. Intellectual Property

## Employee

- Supervision Needed
- Continuous Work
- No Definite End Date
- Generally Works on Premises
- Employees Perform Similar Work
- Training Needed
- Organization Sets Hours of Work
- Equipment Provided by Employer

## Independent Contractor

- No Supervision Needed
- Discrete Project
- Definite End Date
- May Work On or Off Premises
- Specialized Skills
- No Training or Instruction
- Parties Agree Only to Final Completion Date
- Provides Own Equipment

## **Potential Liability**

- Back Pay & Liquidated Damages
- Back Taxes, Interest, & Penalties (1.5% penalty for failure to withhold)
- Disqualification of Company Benefit Plans
- Overtime Liability if contractor would be non-exempt as employee
- Contractor claims 401(k), severance, health/welfare coverage, ESPPs
- Social Security & FICA 6.2% of wages for failure to withhold
- Criminal penalties

# **Compensation**

- Should be project based, not hourly based
- Bonuses are okay if based on criteria different from employees

## **Independent Contractors should not:**

- perform the same or similar tasks as employees
- sit side-by-side with employees
- wear uniforms or name tags provided by the company
- attend staff meetings
- Have company business cards



## **Independent Contractor Agreements Should:**

- Include an explicit statement of IC relationship
- Provide contractor with right to control means and method of performing services
- Have a beginning and termination date, with no automatic renewal
- Be negotiable
- Not prohibit contractor from providing similar services for other clients
- Contain an explicit statement of ineligibility for employee benefits

# Adding Partners and Keeping Key Employees

(See handout)

## ADDING PARTNERS & KEEPING KEY EMPLOYEES

- A. Minority Stockholder
  - 1. Little benefit other than dividends / distributions
  - 2. Big problem
  
- B. Ownership gives you -
  - 1. Voting Rights
  - 2. Economic Rights

However - majority shareholders who are directors may have a fiduciary duty to the minority shareholders
  
- C. Risks of Having Minority Shareholders -
  - 1. Minority Shareholders Oppression
  - 2. Blocking of actions requiring unanimous consent
  
- D. New Partners should bring something more to the table than just work ethic and technical expertise.  
Need to bring:
  - 1. Resources (i.e., cash, credit, assets)
  - 2. Business opportunities
  
- E. Instead of giving real equity, consider phantom stock plans:
  - 1. Benefits
    - a. Economic rights as if employee was an owner
    - b. No tax ramifications upon granting Phantom stock
    - c. No voting rights
  - 2. Drawback
    - a. Payments are considered wages subject to ordinary income tax and employment tax
  - 3. Two flavors
    - a. Capital Events Distributions
    - b. As if and when Distributions
  - 4. Vesting Over Time - (i.e. employee is to get 2% per year over five years - accelerated in certain events).
  
- F. If you are determined to bring on an equity partner then -
  - 1. Fairly value the company as a whole to determine price per share
  - 2. New Partner pays for shares either
    - a. In cash; or
    - b. Loan from the company (which is secured by the shares being purchased)
  
- G. Make sure that the addition of the new partner does not cause a MBE certification problem
  - 1. Control
    - a. Voting stock
    - b. Directors
    - c. Officers
  - 2. Economic Rights
  
- H. Buy-Sell Agreement!

# **Business Succession Planning**

Transferring the business to the  
next generation

# Goals of Succession Planning

- A. Maintaining control
- B. Providing adequate income
- C. Minimizing tax liabilities
- D. Preserve “going concern” status of the business
- E. Provide sufficient liquidity

# Options for Succession

- Sell or Gift to family members
- Sell to key employees in the business
- Sell to a Competitor
- Sell to an Investor

\*Family is often not the best option\*

# Types of Transfers

## Sales

- A. Outright Sale – purchase price paid either in cash or with cash and Note.
- B. Installment Sale – Capital Gains tax can be deferred.
- C. Self Cancelling Notes – sale on an installment basis and note is cancelled at seller's death.

# Types of Transfers

## Gifts

- A. Annual Exclusion - \$13,000  
(\$26k for married couples)
- B. Gift Tax Exemptions
- C. Gifts of family partnership or LLC – can use minority interest / lack of control discounts
- D. Gifts in trust – business transferred to trust for benefit of younger generation.



# Buy-Sell Agreements

- Standard buy-sell agreements:
- The buy-sell agreement provides for smooth transition of a business interest by:
  - 1) identifying triggering events
  - 2) specifying to whom or to what the business interest must be sold
  - 3) providing a mechanism to determine the purchase price
  - 4) providing a funding source, and
  - 5) establishing a valuation for estate tax purposes.

- **BASIC FORMS OF BUY-SELL AGREEMENTS**

- A. Stock Redemption Agreements
- B. Cross-Purchase Agreements
- C. The Mixed Agreement

- **Funding the Buyout**

- Cross Purchase Agreement – Shareholders pay with cash or note payable to Seller
- Redemption Agreement - Company pays with cash or note payable to Seller

- **Some “Basis” Considerations**

If redemption – remaining shareholders get  
no step up

If cross purchase – buying shareholders get  
a step up

- **OPTIONAL LEGAL CLAUSES**

- **A. Drag Along / Tag Along**
- **B. Shotgun**
- **C. Right of first refusal**
- **D. Non-Compete**
- **E. Penalty for leaving  
early/misconduct/involuntary misconduct.**

- **Determining Value of Shares**

- **Agreed upon value (must be constantly adjusted)**
- **Appraisal value upon triggering event**
- **Adjusted book value**
- **Value by formula (i.e. 4 times EBITDA minus long term debt)**

- **Spousal Consent**

It is highly recommended that a spousal consent form be included in all original buy-sell agreements if, for no other reason, to notify the spouse of the existence of such agreement and obtain their consent to be bound by their terms.



## • **TRIGGERING EVENTS**

- A. Death
- B. Disability
- C. Sale to a Third Party
- D. Retirement of an owner
- E. Owner's divorce or bankruptcy
- F. Termination of the Employee

# Tenant Changes To Commercial Leases

(See handout)

## TENANTS' CHANGES IN COMMERCIAL LEASES

1. Lease (accurate and complete) – This is one change to which the landlord shouldn't object, since you are simply making the lease document consistent with the deal (i.e., with the LOI or Term Sheet) stating the names of the parties, the percentage share, the rent, the renewal term you negotiated, and the base year you negotiated.
2. Sublease/assignment (consent not unreasonably withheld) – Standard leases prohibit sublease/assignment without the landlord's prior written consent. Most landlords don't object to adding that landlord's consent shall not be unreasonably withheld, unduly delayed, or conditioned.
3. Default (notice/cure of default) – Tenant should obtain reasonable written notice and an opportunity to cure (i.e., 10 days) before the tenant's failure to pay rent is a default.
4. Liability (mutual waiver of claims) – The tenant should change this so it is a mutual waiver which works in conjunction with the waiver of subrogation.
5. Waiver of subrogation (mutual waiver) – It is important that the tenant obtains a mutual waiver which then works hand-in-hand with the mutual waiver of claims to transfer the risk of loss to insurance.
6. Operating expenses (cap) – Although this is a difficult operating expense change to get for a tenant, it is a tenant's first priority in managing the risk of unreasonable and costly increases in operating expenses.
7. Services (remedy for interruption) – Rent abatement should be sought for any interruption of essential services (such as electricity or water) lasting more than three days and cancellation if the interruption lasts more than 90-180 days. This remedy is similar to tenant's relief if the premises are damaged on account of a casualty.
8. Option-right to renew (tenant's right to renew) – No standard lease gives the tenant the right to stay in the space for another term when the original term ends. The tenant needs this right so it will not be forced to move or renew at higher than market rates.
9. Indemnification (fair allocation) – Make or have each party indemnify the other to the extent of the indemnifying party's fault.
10. Term (commencement date) – Many standard leases simply say that the lease (and rent) begins on a date certain. They do not provide that if the commencement is delayed because of some reason not caused by the tenant (either a current tenant holdover or the landlord has not completed the tenant improvements in time) that the commencement date (as to the Term and rent) shall be delayed.
11. Operating expenses (limit time period for contest) – Most standard leases limit the time period to dispute operating expenses statements. A typical standard lease

limits the period to 30 days after the landlord gives the tenant an operating expenses statement. This acts as an unreasonable statute of limitations and the tenant should argue for no time limit other than the state statute of limitations. The tenant will need to compromise between the unreasonable 30 days and the state statute of limitations period.

12. *Operating expenses (audit)* – Standard leases do not contain a right to audit operating expenses unless the clause is designed to limit the tenant’s right. Since the tenant may not have the right to audit unless expressly provided in the lease, tenant should negotiate the right to audit. The audit right is the only complete method by which a tenant can uncover the errors in a landlord’s operating expense statement.

13. *Environmental (tenant responsibility)* – The majority of standard leases today include a clause dealing with tenant’s environmental responsibility. The key is that the tenant makes sure that the clause is limited to those environmental problems caused by the tenant.

14. *Environmental (landlord responsibility)* – Most of the standard lease environmental clauses do not mention landlord’s responsibility. Even though the tenant may not have caused the environmental problem, it could be liable anyway under applicable law or if not liable, then it could be damaged by having to vacate, have their business operations disrupted, or face workers’ compensation losses for injured employees. So, the tenant would want the landlord bound by the types of covenants, warranties, and indemnities that the landlord imposes on the tenant.

15. *Services (quantity and quality)* – Many standard leases either do not expressly provide for services that the landlord’s agent says will be provided or states the services but states they will be provided in accordance with landlord’s judgment. Since services (e.g., electric) are intrinsic to the essence of what is being leased, all services should be listed with the quantity and quality (e.g., heating, ventilation and air conditioning (“HVAC”) at the following temperature ranges [68-75 degrees Fahrenheit], or in such quantities and at such temperatures as generally provided by other class “A” buildings in the metropolitan area in which the building is located).

16. *Option—right to renew (renewal rent)* –Renewal rental rate will be at fair market value, taking into consideration all relevant factors (such as size of space, need for tenant improvements, etc.)

17. *Default (offset)* – When the landlord defaults, the standard landlord lease gives the tenant limited remedies. Almost all standard leases prohibit the tenant from offsetting the rent. Although even a partial offset is difficult to obtain, it is so critical a remedy that it is included in the top 50.

18. *Workletter (allowance)* – The workletter is the document setting forth the parties obligations regarding building out the space, and usually provides that the tenant will be responsible for paying for the buildout costs exceeding the allowance. So the integrity of the allowance is critical. The tenant needs to make sure that the allowance can be applied to all of its costs including the preparation of plans, etc.

19. **Workletter (competitive bidding)** – In the typical small lease the landlord builds out the space. Since the tenant will pay the costs exceeding the allowance, it is important that the costs incurred be priced competitively.

20. **Use (general office)** – Many standard leases list the use as the specific requested use (such as “accounting office”) which limits any potential subleases (since limited by use clause) and prohibits tenant from using the premises for a different office use. Instead, list the specific use and “general offices.”

21. **Square footage (measurement)** – Most standard leases today state that the square footage is an agreed-to amount. Since the amount of square footage can greatly affect the amount of money you will pay over the term this is a very important issue. The lease should specify how square footage was measured (e.g., Building Owners and Managers Association (“BOMA”)). You may have to take out a tape measure and measure it yourself unless your architect is able to give you a good computer aided design (“CAD”) measurement.

22. **Alterations (removal obligation)** – Since the landlord is usually not any worse off because of your alterations (either the new tenant can use them or the landlord would have to demolish them as they would have the original build-out) this should be changed. The agreeable change is requiring the landlord to make the removal election at the time the alterations are to be made instead of at the end of the lease.

23. **Damages (right to abate and cancel)** – Most standard leases don’t provide for cancellation and many others allow rent abatement only for covered casualties. Landlords generally will agree to abate rent regardless of whether it is a covered casualty since they can obtain rent insurance and will agree to cancellation if the premises are not repaired within a specified time (e.g., 180 days).

24. **Sublease/assignment (recapture)** – Most standard landlord leases allow the landlord to recapture the space (take it back) if the tenant wishes to sublease and allows the landlord to make this decision within 30 days after the tenant obtains a subtenant. If the tenant is unable to delete this clause, it should change it so the landlord must make its recapture decision at the time tenant announces its desire to sublease, rather than after tenant goes through the entire process to obtain a subtenant. Changing the point in time when the landlord must make its decision saves the tenant the brokerage fee and the time involved as well as eliminating a potential roadblock to obtaining a subtenant (some subtenants may refuse to even consider space that can be pulled out from under them by the landlord at the last minute).

25. **Repairs (landlord obligation)** – Many standard leases do not impose any repair obligation on the landlord. At a minimum the lease should state that the landlord will maintain, repair, and replace the roof, structure, load bearing walls, and all systems (HVAC, electrical, plumbing, and mechanical).

26. **Non-disturbance** – Although more leases today include non-disturbance clauses (protection against lender/mortgagee kicking the tenant out upon the landlord’s foreclosure) the majority still require subordination without non-disturbance.

27. **Relocation (delete or limit)** – If the particular location of the premises is important then this clause is critical. This clause allows the landlord to move the tenant to new premises so the tenant should either delete this clause or limit where you can be moved (e.g., same building, same floor, elevator exposure, no lower than the 50th floor). Small tenants may have to agree to be relocated so a large tenant can be accommodated, but they should negotiate the terms of that relocation.

28. **Default (mitigation)** – Most standard leases do not require mitigation of damages by landlord if tenant defaults. And, state caselaw may or may not require it. So, a tenant should require the landlord to mitigate.

29. **Workletter (quality)** – In a typical lease the landlord builds out the premises agreeing to pay an “allowance” and the tenant is responsible for the buildout costs in excess of the allowance. The landlord’s standard workletter tends to leave out things like: the quality of the buildout, performing the work in a good and workerlike manner, compliance with laws, and warranties. So, the tenant needs to add those protections.

30. Americans with Disabilities Act (warranty of compliance);

31. Alterations (consent not unreasonably withheld to nonstructural interior alterations that do not adversely affect systems);

32. Arbitration (required arbitration for specified disputes);

33. Attorneys’ fees (prevailing party wins);

34. Default (no unreasonable remedies such as rent acceleration);

35. Holdover (reasonable amount);

36. Insurance (landlord’s insurance requirement stated);

37. Lender modification (no material adverse effect on tenant’s rights or obligations);

38. Operating expenses (landlord pays for audit if discrepancy exceeds fixed percentage);

39. Operating expenses (landlord must submit itemized annual statement of expenses);

40. Parking (rights specified);

41. Premises (condition at commencement);
42. Relocation (all costs paid by landlord);
43. Remedies (specify tenant's remedies for landlord default);
44. Rent (add grace period before late rent penalty);
45. Rent (limit to one-time fixed charge or interest, not five percent monthly penalty until paid);
46. Rules (limit future rules to those which don't increase Tenant's obligations or decrease Tenant's rights);